No. 92-1384

In the Supreme Court

OF THE

United States

OCTOBER TERM, 1992

BARCLAYS BANK PLC
Petitioner,
vs.
FRANCHISE TAX BOARD,
An Agency of the State of California
Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE COURT OF APPEAL OF THE STATE OF CALIFORNIA IN AND FOR THE THIRD APPELLATE DISTRICT

PETITIONER'S REPLY BRIEF

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INTRODUCTION

Respondent admits that this case squarely presents the issue which this Court expressly reserved in *Container Corp. of America v. Franchise Tax Board*, 463 U.S. 159, 189 n. 26, 195 n. 32 (1983). Respondent's Brief in Opposition (hereafter "R.B.") at 10. Respondent does not deny, nor can it, that this issue is one of great national and international importance. In fact, respondent essentially admits that worldwide combined reporting "has a direct impact upon foreign relations" and "may well adversely affect the power of the central government to deal with foreign affairs issues." R.B. at 21. The numerous amici curiae briefs in support of this petition, including those from the United Kingdom and from the Member States of the European Communities and the governments of Australia, Austria, Canada, Finland, Japan, Norway, Sweden and Switzerland, demonstrate that this reserved issue remains closely watched, and, as we write today, the United Kingdom is discussing what further steps it may take. The stakes

are high — the unravelling of over 60 years of international cooperation on an agreed upon standard for division of income among nations.

Respondent contends nevertheless that review should be denied because this Court's decisions in *Wardair Canada, Inc. v. Florida Department of Revenue*, 477 U.S. 1 (1986), and *Itel Containers International Corp. v. Huddleston*, ____ U.S. ____, 113 S. Ct. 1095 (1993), allegedly support the decision of the California Supreme Court. On the contrary, the California court's decision represents a gross misreading of this Court's decisions and in fact stands commerce clause jurisprudence on its head.

These issues will not go away. As commerce becomes global, more and more questions before the Court on the oft recurring issue of the states' rights to burden commerce are now arising in the context of foreign commerce. Failure to resolve the important issues presented herein will only stimulate further aggressive and unconstitutional taxation not just by California but by the numerous other states which are already contemplating alternative systems to tax international business. This case is uniquely well positioned as a vehicle for such resolution.

For these reasons, this Court should grant certiorari.

ARGUMENT

I. THE ISSUES PRESENTED HERE ARE AND CONTINUE TO BE MATTERS OF GREAT NATIONAL AND INTERNATIONAL SIGNIFICANCE.

At the outset it should be emphasized that the issues in this case remain ones of great and ongoing concern. Respondent attempts to suggest in various ways that the issues have been resolved. Respondent is wrong.[1]

[1]For example, respondent mentions the 1986 California water's edge elective legislation (effective in 1988), but respondent markedly omits the fact that taxpayers which elect must pay annual fees for this "privilege" (in addition to the tax) aggregating $60 million to $100 million per year. Such legislation also has other burdens and penalties. Worldwide combined reporting still remains as the basic California system. The United Kingdom, the United States and the European Communities have stated that the legislation does not resolve the important issues in this case.

This Court has stated that the threat of offending our foreign trading partners and leading them to retaliation constitutes the most obvious example of foreign policy implication of a state tax. *Container*, 463 U.S. at 194. This case involves actual retaliation, as well as numerous and ongoing threats, not just by the United Kingdom but by the United States' major trading partners.

At stake here is the preservation of the internationally accepted standard for the division of income among nations for tax purposes, the arm's-length separate entity accounting method. Respondent does not deny that this is the international standard, and this Court has so found. *Container*, 463 U.S. at 184. Respondent does not deny that worldwide combined reporting is an incompatible and conflicting system. As the amici in this case have stated, nations fear the loss of the uniform standard which has provided the framework for resolutions of difficult and sensitive issues for 60 years. If California's method is allowed to stand unchallenged, its presence as a second and competing system can only result in continued turmoil and controversy.

This issue is not only of importance to governments. The amicus briefs from both foreign and domestic business interests show that the issues affect both domestic owned and foreign owned multinational businesses and create ongoing and recurring problems. As Amici National Foreign Trade Council, Inc. et al. state, the issue has enormous practical importance for the United States' economy:

> Allowing the California decision to stand could well provoke a cascade of international retaliatory actions, the consequences of which for the U.S. economy, for U.S.-owned foreign businesses, and for the global economy as a whole are likely to be extremely damaging. At a minimum, government-imposed economic counter-measures will almost certainly skew international investment decisions, disrupting the flow of foreign capital into the United States and reducing the attractiveness of foreign investment for U.S. businesses.

Brief for National Foreign Trade Council, Inc. et al., as Amici Curiae in Support of Petitioner at 13. In addition to the National

Foreign Trade Council, Inc., amici on this brief in support of petitioner include the National Association of Manufacturers, the Chamber of Commerce of the United States of America, the Business Roundtable, the United States Council for International Business, the Emergency Committee for American Trade, the American Petroleum Institute, the Chemical Manufacturers Association, the Financial Executives Institute, the Tax Council, and the California Chamber of Commerce. To similar effect, the Committee on State Taxation states:

> This Foreign Commerce Clause issue is of such importance to international trade and the retaliatory threat to domestic corporations so immediate that it must not be left unanswered by this Court any longer.

Brief of the Committee on State Taxation as Amicus Curiae in Support of Petitioner at 9. Amici curiae for foreign business express similar concerns.

All amici express dismay over the long delay in resolving this issue and fears over the effect of further delay.

Respondent implies that the United Kingdom is perhaps unjustified in enacting retaliatory legislation and seeking resolution of this issue. Respondent states that such retaliatory legislation has not been implemented and that implementation might violate the United States/United Kingdom tax treaty. R.B. at 6. Respondent ignores the fact that every major trading partner of the United States has joined the United Kingdom in protests, complaints and diplomatic action. As this brief is written, the United Kingdom is discussing what further steps it may take, including reopening the treaty. The United States itself in its amicus curiae brief filed in the California Supreme Court answers the issue of justification:

> Appellant [now respondent] also argues that the conduct of foreign affairs is not significantly implicated because the retaliation by Great Britain is not justified under United States law. It is submitted that the conduct of foreign affairs is necessarily determined not by whether a foreign country's actions are justified under our law as opposed to foreign law but rather whether there is a dispute with a foreign country and what is the most efficient and beneficial manner of resolving that dispute. Accordingly, whether or not Great Britain's retaliatory legislation is or is not justified under our law is of no great moment. The fact remains that a potentially serious dispute exists with Great Britain, and retaliatory legislation by Great Britain is in place, both of which can have adverse effects on United States' foreign commercial relations.

Brief Amicus Curiae of the United States in Support of Plaintiffs and Respondents, App. H at 41 n.18. Respondent also suggests that the United Kingdom had somehow bargained away its right to complain about California's method. R.B. at 5-6 and 15. Respondent misstates the record. The United Kingdom did not ratify the treaty only after "exact[ing] other federal tax concessions from the United States." R.B. at 15. The United Kingdom made it quite clear at the time of the ratification that it expected the problem of worldwide combined reporting to be solved. App. A at 44, ¶ 32c (exhibit 32C, Demarche 51); App. A at 72, ¶ 37h (exhibit 37H, p. 80). The efforts of the U.S. federal government subsequent to the ratification of the treaty clearly indicate that neither the United States nor the United Kingdom saw the treaty as any final resolution on the question of the states' use of worldwide combined reporting. Reporter's Transcript ("R.T.") at 417-18; exhibits 32C, 34.

II. THE DECISION OF THE CALIFORNIA SUPREME COURT CONFLICTS WITH THIS COURT'S EXISTING DECISIONS.

Respondent's essential contention is that this Court need not review this case because the California Supreme Court decision is, allegedly, a correct application of existing precedent. However, respondent's "existing precedent" is *Wardair* and *Itel*, neither of which stands for the propositions advanced by either the California court or respondent, and both of which actually support petitioner.

In actuality, the California Supreme Court has ignored existing precedent. That court specifically rejected this Court's dormant commerce clause precedents under *Japan Line, Ltd. v. County of Los Angeles*, 441 U.S. 434 (1979) and *Container* on the ground that *Wardair* "reoriented" commerce clause jurisprudence. It is for this Court, not the California courts, to engage in any such

"reorientation" which in effect overrules this Court's *Container* case.[2] *Rodriguez de Quijas v. Shearson/American Express, Inc.*, 490 U.S. 477, 484 (1989).

Further, neither the California court nor respondent addresses the conflict between the California Supreme Court's decision and other existing precedent such as this Court's longstanding requirement, confirmed both before and after *Wardair*, that the congressional consent needed to remove a state tax from commerce clause scrutiny must be specific, unambiguous, and based on an affirmative text. *See, e.g., Wyoming v. Oklahoma*, ____ U.S. ____, 112 S. Ct. 789 (1992).[3]

In truth, *Wardair* can hardly be said to constitute precedent for the California court's new approach to determine whether Congress has exercised its power over foreign commerce. *Wardair* involved an affirmative congressional text. This case does not. There is a world of difference between the specific legislation of the Chicago Convention in *Wardair* (which addressed state taxes on aviation fuel and specifically prohibited some state taxes on such fuel, but not the Florida tax at issue there) and the ratification here of the United States/United Kingdom tax treaty without a provision barring states' use of worldwide combined reporting. The Chicago Convention represented an international consensus on the solution of the problem: a partial prohibition. In contrast, here a majority of the Senate voted twice to ban worldwide combined reporting but a minority of the Senate blocked that clear majority from achieving the necessary two

[2] Respondent never explains why this Court's discussion of California worldwide combined reporting subsequent to *Wardair* refers to both *Japan Line* and *Container* as the controlling precedents without mentioning *Wardair* or "reorientation." *See Franchise Tax Bd. v. Alcan Aluminium, Ltd.*, 493 U.S. 331, 334-35 (1990).

[3] Respondent chides the California Court of Appeal for discussing the discrimination issue on remand (R.B. at 23 n.8), but this is a sterling example of why the California Supreme Court's approach in the absence of enactment is unworkable. Without a congressional text, the Court of Appeal had no way to tell whether Congress' alleged "silent acquiescence" in worldwide combined reporting extended to the imposition of discriminatory compliance burdens.

thirds vote on the treaty as a whole. This absence of affirmative legislation can hardly be said to represent a consensus of the Senate approving states' use of worldwide combined reporting.

Indeed, this Court has already determined that Congress has not acted, either to proscribe or permit the use of worldwide combined reporting by the states. *Container*, 463 U.S. at 194, 196. This Court has already addressed the United States/United Kingdom tax treaty and the other items upon which the California court relied as evidence of "acquiescence,"[4] and has held that none of these constitute either "explicit" congressional action or even "indications" of congressional intent. *Id.* There must be some enactment addressing the issue. No such enactment evidencing Congress' exercise of its power exists in this case.

Respondent's reliance on *Itel* is similarly misplaced. In *Itel* this Court clearly *followed* the dormant commerce clause analysis used in both *Japan Line* and *Container*. The Tennessee sales tax neither created a risk of international multiple taxation under the first prong of the *Japan Line* test,[5] nor infringed on government's ability to speak with one voice when regulating commercial relations with nations, the second of the *Japan Line/Container* dormant commerce clause tests.[6]

[4] All of which were before this Court in *Container*. *See* Brief for Nestlé Holdings Inc. et al., as Amici Curiae in Support of Petitioner for Writ of Certiorari at 19.

[5] Tennessee gives a credit against its own tax for taxes paid to another jurisdiction in the same transaction, thus eliminating risk of multiple tax. In contrast, California gives no credit. California does not even give a deduction.

[6] This Court noted that the Tennessee tax does not fall within the class of state taxes specifically prohibited by the various container conventions. The United States, appearing as amicus, stated that the Tennessee tax did not conflict with international custom. Respondent twice mentions the dissent of Justice Blackmun which refers to, among other things, the majority's "inference" of congressional consent. However, in *Itel*, as in *Wardair*, there is congressional enactment and hence text dealing with some state taxes. Further, the majority clearly used a dormant commerce clause analysis, it did not reject such analysis as did the California court. Justice Scalia's partial concurrence in *Itel* confirms that this Court is applying such dormant commerce clause analysis.

III. THIS COURT SHOULD ALSO GRANT CERTIORARI ON THE DISCRIMINATION AND DUE PROCESS ISSUES.

This Court should also grant certiorari with respect to the discrimination and due process issues.

With respect to the discrimination issue, respondent essentially ignores this Court's decision in *Hunt v. Washington State Apple Advertising Commission*, 432 U.S. 333 (1977), which struck down an allegedly even-handed grading system that deprived Washington apple growers of the use of their own established system and, by requiring alteration of their packages to conform to the new system, increased the cost of those already far from the market. A presumably "neutral" rule is no defense where, as here, identifiable groups of taxpayers are differently and adversely affected by the rule's application.[7] As this Court said in *Fort Gratiot Sanitary Landfill, Inc. v. Michigan Department of Natural Resources*, ____ U.S. ____, 112 S. Ct. 2019, 2025 (1992), quoting with approval from *Brimmer v. Rebman*, 138 U.S. 78, 82-83 (1891):

> [T]his statute [cannot] be brought into harmony with the Constitution by the circumstance that it purports to apply alike to the citizens of all the States, including Virginia; for "a burden imposed by a State upon interstate commerce is not to be sustained simply because the statute imposing it applies alike to the people of all the States, including the people of the State enacting such statute."

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[7]Respondent also seeks to downplay the costs imposed by worldwide combined reporting. R.B. at 3 n.1. After initially affirming the findings of the trial court, on the basis of substantial evidence, that the cost to set up and maintain the system in compliance with the California regulations was huge ($5 million to set up and $2 million per year to maintain), the Court of Appeal on remand, in its discussion on due process, mistakenly referred to the incorrect filing for BBI as evidence of overall burden. BBI's returns in the early 1970s, filed without including either Barclays Bank of California or Barclays Bank Limited and its direct subsidiaries other than BBI, were not in compliance, were rejected by respondent and therefore have no relevance here.

There can be no dispute about the disparate impact of the California method between foreign and domestic business.[8] Foreign multinationals clearly bear a burden in responding to respondent's system that domestic multinationals or interstate businesses do not bear.[9] *Kraft Gen. Foods, Inc. v. Iowa Dep't of Revenue and Fin.*, ____ U.S. ____, 112 S. Ct. 2365 (1992); *see also Japan Line*, 441 U.S. 434.

Similarly, Respondent attempts to sidestep the due process issue by characterizing it as a matter of construction of California law. R.B. at 27. Respondent misstates the nature of petitioner's argument. Petitioner does not dispute here the California court's construction, but rather submits that the law, as construed, still violates due process.

As construed, the Regulation's "relief" provisions still give no meaningful guidance on what the Franchise Tax Board must accept. Taxpayers still must negotiate the "what" under threat of penalty. At best, such provisions result in a filing under a different regime (financial accounting information as opposed to tax accounting information). This often produces higher tax and cer-

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[8]Foreign taxpayers also face loss of tax benefits. *See New Energy Co. v. Limbach*, 486 U.S. 269 (1988). Contrary to respondent's misstatement of the record, its staff stated that they would deny tax benefits without proper records. R.T. at 349-53, 355-57, 379-80.

[9]Respondent's reliance on *Cotton Petroleum Corp. v. New Mexico*, 490 U.S. 163 (1989) is misplaced. In that case, this Court held that both the State of New Mexico and the Apache Indian Tribe (as well as the United States) had concurrent jurisdiction to tax oil wells located on the reservation in the State of New Mexico. There was no claim in that case that the state tax imposed severe or discriminatory compliance burdens. Nor were any of those jurisdictions asking worldwide information about any operations. Further, respondent's reliance on *Trinova Corp. v. Michigan Department of Treasury*, ____ U.S. ____, 111 S. Ct. 818 (1991) is misplaced. That case did not involve discriminatory compliance burdens, and the taxpayer in that case made no claims of discrimination other than vague allegations. Here there is actual discrimination.

tainly inconsistent tax, itself a form of discrimination.[10] In short, the efforts of the California court to "fix" these provisions do not cure their discriminatory and arbitrary nature. They remain violative of due process.

CONCLUSION

These issues are important. They will not go away. Their resolution affects fundamental constitutional jurisprudence. Failure to resolve these issues will open the floodgates of diverse state schemes to tax international business, each of which will embroil this Court in further controversies if this Court does not reaffirm its longstanding dormant commerce clause principles. This Court should grant certiorari.

DATE: April 28, 1993

Respectfully submitted,

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[10]As one witness stated, what was acceptable one year might not be acceptable the next. R.T. at 934-38. Further, denial of tax benefits will result in higher cost.